British Columbia Railway Group of Companies Annual Report for 1989

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The people of BC Rail are a community as different in their lifestyles, interests and backgrounds as the people of any other community. The one thing they have in common, however, is the contribution they have made and continue to make to the company's success.

BC Rail today is a respected contributor to the prosperity of the community at large and its social, economic and functional worth is very much a reflection of the support it receives from its employees and their families. While it is impossible to honour each employee individually, the following pages depict and identify as large a cross-section of the people of BC Rail as possible—and it is with a great deal of pleasure that I dedicate this report to all members of the BC Rail community, for making us what we are today.

Paul McElligott
President and Chief Executive Officer

BCRAIL

PRINTED ON RECYCLED PAPER

Hon. Rita M. Johnston, M.L.A., Minister of Transportation and Highways and Lead Machinist Al Broadfoot discussing government-assisted steam train operation.

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NOTICE OF SPECIAL MEETING

For Non-voting Preferred Shareholders

The Board of Directors and Management of BC Rail Ltd. cordially invite preferred shareholders to an informational meeting on June 12, 1990. The meeting will start at 10:00 a.m. and be held in the Plaza Centre of the Hyatt Regency Hotel, 655 Burrard Street, Vancouver, B.C.

The meeting is not a legal requirement and it is offered as a courtesy to the company's preferred shareholders. Its purpose is to report on company activities and performance during 1989 and on the outlook for the current operational year. The informational meeting is open to the general public. It follows the company's annual general meeting, which is open only to common shareholders, directors and officers of the company.

For further information, please call:

Ms. C. A. Lee
(604) 984-5291

Contact Information:
If you would like more copies of this report or additional information about the British Columbia Railway Group of companies, please call or write: BC Rail, Corporate Library, P.O. Box 8770, Vancouver, B.C., V6B 4X6 (604) 986-2012

CORPORATE PROFILE

The British Columbia Railway group comprises three companies:

— British Columbia Railway Company, which holds investments in two subsidiary companies

— BCR Properties Ltd., which owns and manages the group's non-operating real estate assets and

— BC Rail Ltd., the group's operating railway company.

The Province of British Columbia is the sole shareholder of British Columbia Railway Company, which holds 100 per cent of the common shares of BCR Properties Ltd. BCR Properties Ltd. owns 75 per cent of the common shares of BC Rail Ltd., the remaining 25 per cent of which are held by British Columbia Railway Company.

The group is principally engaged in the transportation of forest products, coal, ore concentrates and other natural resources. It is also involved in real estate development, telecommunications marketing, road transportation and transportation consulting.

BC Rail operates 1,242 miles of trackage within British Columbia. It has interline connections to all rail-served points in North America.

CHAIRMAN'S REPORT

I am pleased that the British Columbia Railway group has achieved further improvements in financial performance and that 1989 was a successful operating year. While management and employees can be proud of their contribution, however, the results indicate a continuing need to improve revenue growth and return on capital investment.

The latter remains lower than that of a number of other railways in North America and revenues, while growing, are doing so at a rate considerably lower than the rate of inflation. If the railway is to generate the capital necessary to remain efficient and competitive, these are matters which clearly must be addressed.

While operating income increased, consolidated net income was adversely affected by an extraordinary charge arising from the write-off of the most northerly portion of the railway's Dease Lake line. As a result, the detailed financial statements show a year-end net loss.

That the company has advanced as far as it has during the last two decades is in no small way a tribute to the leadership of its former President and Chief Executive officer M. C. (Mac) Norris. Among many other accomplishments, Mr. Norris transformed the company both physically and financially during his 19 years of

service and played a major role in restoring the employee pride which declined during the years of losses and poor operating performance. Mr. Norris was the inspiration and driving force behind the renaissance of BC Rail, and in his retirement he can take pride in the fact that the company he left behind is as successful as it is.

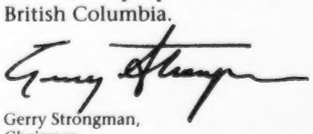
On behalf of the Board, I offer our good wishes for many long and healthy retirement years.

In many ways, the start of the new decade is a turning point for the company. Thanks to the legacy of first class physical plant and equipment, the stage is now set for a change of emphasis in BC Rail, which will be accomplished under the leadership of our new President and Chief Executive Officer, Paul McElligott.

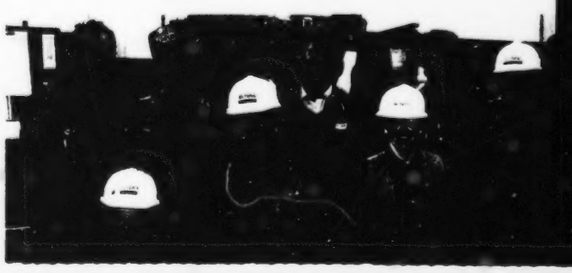
Mr. McElligott brings with him a reputation for fairness, as well as excellent marketing and people management skills, and I am confident that under his leadership and expertise, the railway will continue to prosper and grow. Many employees have already met Mr. McElligott during the normal course of business. I would now like to extend a public welcome to our new president and, on behalf of the Board, say how much we are looking forward to working with him. I know the people of BC Rail will join him enthusiastically and share the excitement of charting a new course for the company.

It is time to build on the excellent operating railway, our employee strength and first class reputation, to create the market-driven and service-oriented company envisaged by Mr. McElligott and the Board.

I believe the changes and challenges ahead will be positive for the railway, its customers and its employees — and its owners, the people of the Province of British Columbia.



Gerry Strongman,
Chairman



BOARD OF DIRECTORS

Standing, left to right: Winton K. Derby; Edward John; Gerry Strongman, Chairman; Victor Bowman; James T. Rabbitt, M.L.A.; E.A. Moffat.

Seated: Jim Inkster; Paul J. McElligott, President and Chief Executive Officer; E. Beverly Ellis.

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OFFICERS

Paul J. McElligott, *President and Chief Executive Officer*
Wayne C. Banks, *Vice-President – Marketing and Sales*
J.R. Clarke, *Vice-President – Finance and Information Services*
Brian Foley, *Vice-President – Human Resources, Engineering and Communications*
J.C. Trainor, *Vice-President – Operations and Mechanical*
R.W. Young, *Vice-President – Real Estate and Administration*

FINANCIAL HIGHLIGHTS

	(Dollars in Thousands) 1989	1988
Operating revenues	$328,953	$326,994
Operating expenses	$241,715	$242,709
Operating income before extraordinary item	$ 64,589	$ 58,316
Extraordinary item – Note 2	$ (80,646)	
Net income (loss)	$ (16,057)	$ 58,316
Total freight tonnage hauled	16,955,000	17,340,000
Employees at year end	2,700	2,700

PRESIDENT'S REPORT

I am pleased to report consolidated income of $64.6 million for the British Columbia Railway group of companies, before the extraordinary item, which represents an increase of 11 per cent over the $58.3 million reported for the preceding year. As a result of an extraordinary charge, however — namely, the $80.6 million write-off of the northern section of the Dease Lake extension — the group ended the operating year with a consolidated net loss of $16.1 million.

While 1989 was the eighth successive year of improvement in operating income, the group's return on capital investment has ranged between five and seven per cent per annum over that period. This is below the return enjoyed by many other North American railways and improvements in this area will continue to be pursued.

While operating results have continued to improve over the past eight years, I am less encouraged by the fact that revenue growth since 1985 has averaged only two per cent — which is considerably below the rate of inflation. In 1989, consolidated freight revenues were below the 1988 level.

If the company is to generate the returns needed for it to flourish as an

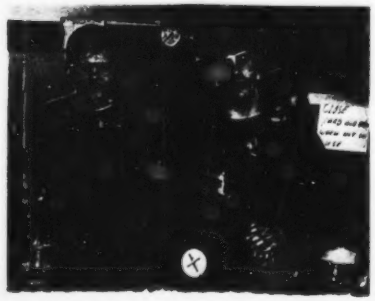
efficient and competitive carrier, steps must be taken to protect existing markets and, more importantly, develop new markets and services in order to enhance its revenue picture. My executive management colleagues and I will be addressing these concerns in the months ahead.

The write-off of the Dease Lake line followed a re-evaluation of the company's assets late last year. Construction on the line began in the early 1970s, on the assumption that if a transportation system were in place, economic development would follow. Traffic prospects did not materialize, however, and rising costs — based on revised construction standards — led to a cessation of work in 1977.

The line's retention as an asset distorted the true value of the company and in keeping with recognized accounting procedures, the decision to write off the investment was taken near year end.

Having joined the group only during the second half of 1989, I feel fortunate in having inherited a railway which, thanks to the extraordinary contribution of my retired predecessor Mac Norris, is in first class operating condition. I am also encouraged by the levels of employee competence, pride and enthusiasm I have encountered during my travels through the company and I know too, that much of this also can be attributed to the leadership of Mr. Norris.

With this excellent infrastructure and employee strength in place, we can confidently begin intensifying our marketing and sales effort so as to protect and expand our traditional sources of revenue. There is no question that the company faces serious competition from the road haulage industry — which unlike railways makes only a minor contribution to right-of-way construction and upkeep — and if further erosion of our traffic base is to be prevented, new avenues of development must be aggressively explored.

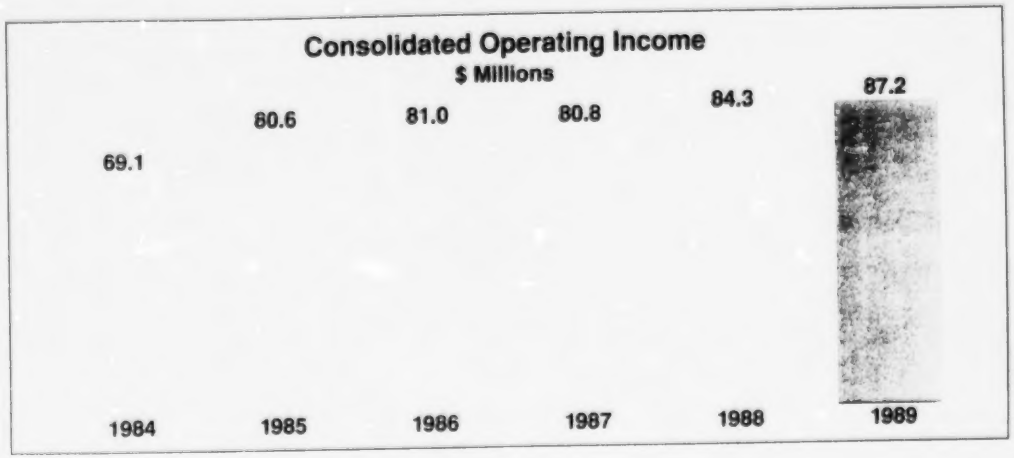


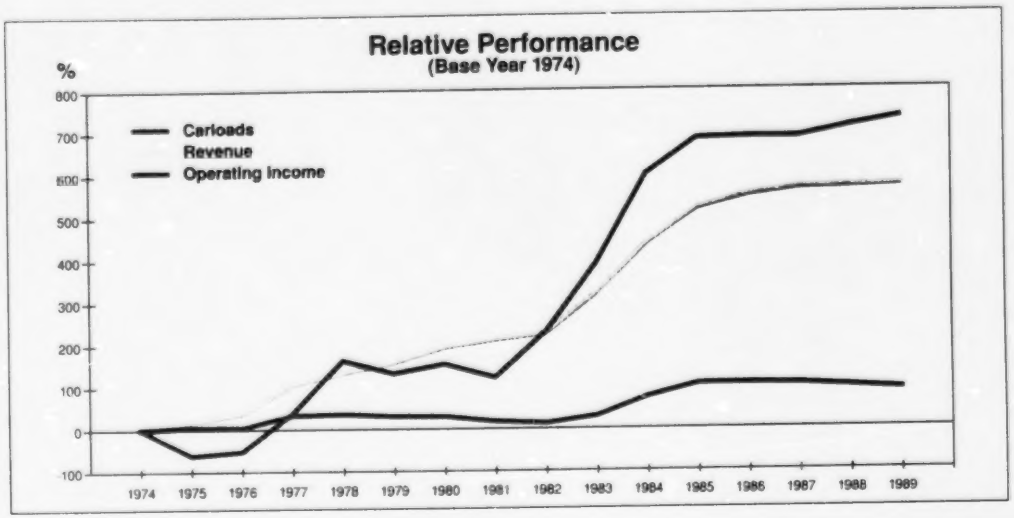
The relaxation of weight and size restrictions for road vehicles, coupled with extremely competitive rates for road hauls from northern B.C. to southern railheads, are making serious inroads into BC Rail's traditional markets. To succeed in the face of such competition, the railway must develop new marketing initiatives to secure additional traffic and improve utilization of existing capacity.

Ultimately, however, our success or failure as a commercial enterprise depends on the goodwill and loyalty of customers and we must accept that their satisfaction is paramount and a prime responsibility for us all.

The BC Rail of the 1990s will be a market-driven, customer-focused enterprise, with the emphasis on delivering outstanding service at competitive prices. With that in mind, the company's Marketing and Sales division was strengthened and restructured during a recent management reorganization, which was undertaken to position the railway for the very different challenges which undoubtedly will face us in the next decade.

In addition to augmenting the Marketing and Sales division, a new Vice-Presidency of Real Estate and Administration was created and in

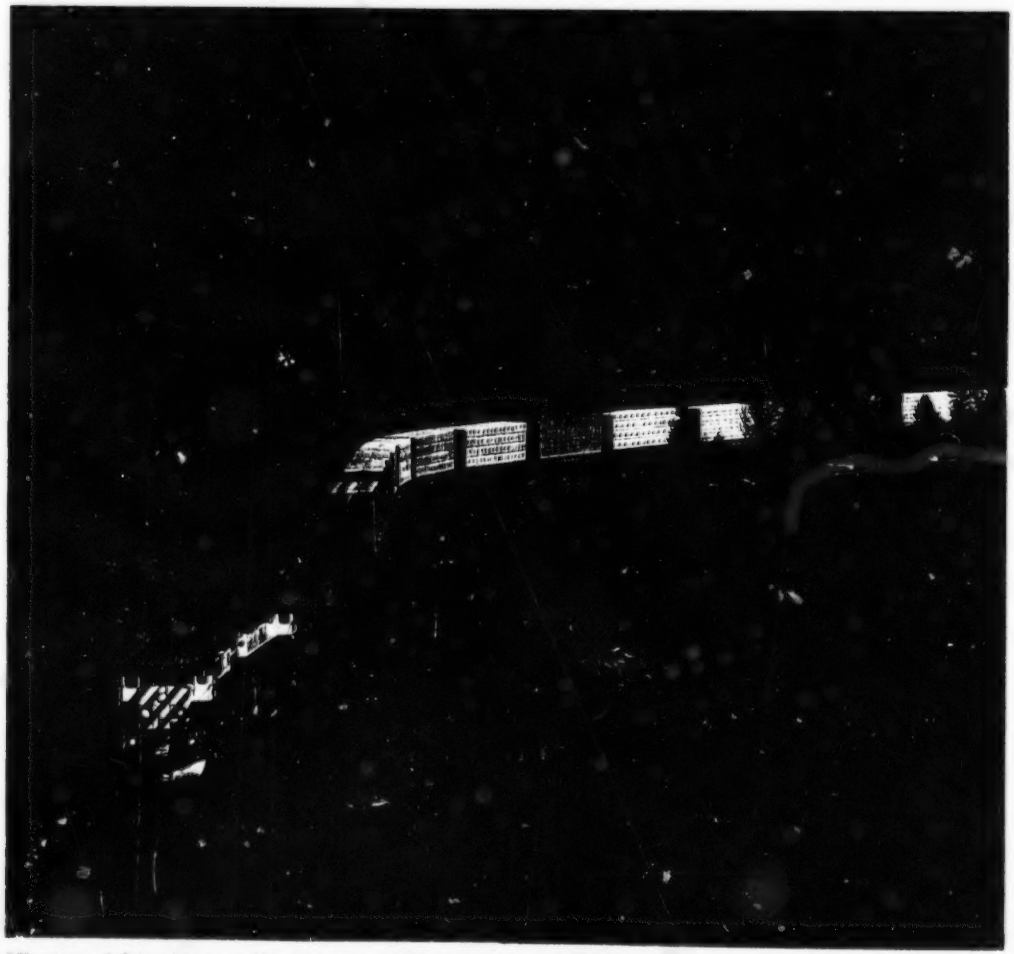




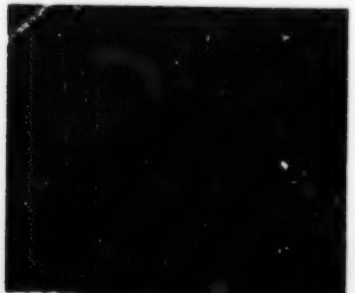
due course, the addition of a Vice-President of Strategic Planning and Business Development will be announced. In conclusion, I would like to pay a special tribute to my fellow employees at BC Rail, for their co-operation in making 1989 our company's most successful operating year ever. I enjoyed the frank discussions I had with many of them during my first few months with the company. With the talents and commitment they continue to demonstrate, I am confident we can meet the challenges that lie ahead.

I thank them all. And it is to the employees of BC Rail, at all levels and in all locations, to whom this annual report is respectfully dedicated.

Paul McElligott
President and Chief Executive Officer



Nineteen-eighty-nine was the most successful operating year in the railway's 77-year history.



THE RAILWAY AND THE PROVINCE

As a Crown-owned commercial corporation, British Columbia Railway Company is provincially regulated and responsible to the government of British Columbia through the Minister of Transportation and Highways, Hon. Rita M. Johnston.

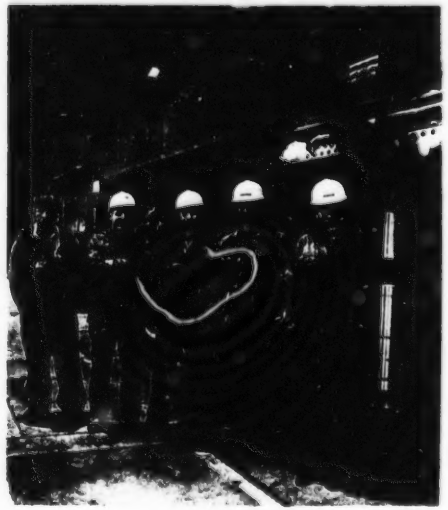
With the exception of uneconomic services operated at government request, the railway is self-sufficient and meets all operating and capital expenditures from its own resources. In 1989, the company received approximately $15 million in provincial government assistance towards the operation and rehabilitation of the Fort Nelson line and the modernization and operation of the railway's passenger service.

As a matter of corporate policy, BC Rail supports the provincial government's supplier development program, which is designed to encourage the purchase of goods and services from British Columbia manufacturers and suppliers. The railway is an active participant in the government-sponsored Crown Corporation Supplier Development Task Force and in 1989, the railway obtained more than 50 per cent of its purchased supplies from within the province.

Transportation Minister Johnston and Passenger Manager Paul Perkins with a refurbished Budd car at North Vancouver depot.

Purchases committed during the year comprised $155 million in goods and services and a further $43 million in engineering contracts and other services for a total of $198 million. Of the totai, approximately $105 million was committed or expended in British Columbia.

The railway employed 2,700 British Columbians at year end, in more than 20 locations between Vancouver and Fort Nelson, 980 miles to the north. Including taxable benefits, the company's 1989 payroll was $119 million.



Historic Royal Hudson underwent complete overhaul and boiler re-tube prior to steam excursion start-up in May, 1990.

THE YEAR IN REVIEW

While increasingly vigorous competition from other carriers inhibited revenue growth, the British Columbia Railway group has reported its eighth successive year of improved operating results for 1989. After provision for preferred share dividends and an extraordinary charge for the write-off of the Dease Lake extension, however, the group ended the 1989 operating year with a consolidated net loss of $16.1 million.

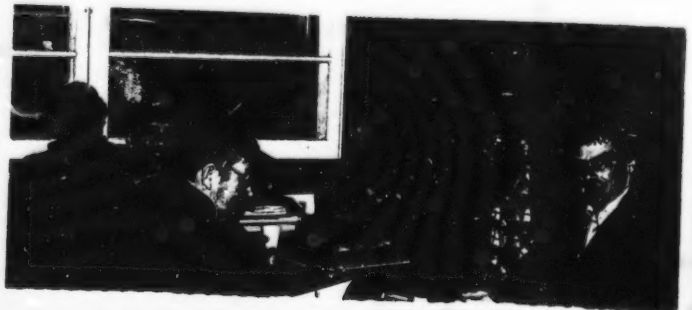
Prior to these items, railway operating income stood at $82.5 million, compared with $76.8 million for the previous year. The written-off section of the Dease Lake line was recorded at $80.6 million. Preferred shareholder dividends amounted to approximately $18 million. As in earlier years, the company paid a dividend of $10.3 million to its sole common shareholder, the provincial government.

Income improvements resulted from a small increase in railway operating revenues — from $319.7 million in 1988 to $319.9 in 1989. These revenues were augmented by approximately $8 million in provincial government assistance, which was provided for the operation and maintenance of the Fort Nelson extension and the passenger service, both of which the railway is required to operate in the public interest.

A tower survey on Pavilion Mountain summit is part of a four-year microwave communications upgrade program.

The lack of revenue growth is a source of concern throughout the North American railway industry; the need to meet competition from low-cost road carriers is creating downward pressure on revenues and yields and posing a serious threat to rail carriers in general. The company will be taking steps to improve both its revenue base and market share position in 1990.

To assist in planning a new course for the '90s, a strategic marketing study was commissioned at year end and early in the new year, the company announced plans to add resources to its marketing and customer service effort. To that end, management responsibilities have been realigned and a new corporate structure was implemented in February, 1990.



Market initiatives

In late fall, the railway's forest products department announced initiatives to penetrate new markets in U.S. western and mid-western states. As a result of agreements with connecting carriers, BC Rail is offering competitive rates to these new markets with a view to increasing its share of available traffic.

Operationally, the railway has initiated steps to introduce a computer-supported method of train dispatch and control aimed at improving safety and productivity. The system will provide a single, uniform method of train control to replace two methods currently in use.

Construction of 22 new, 4,000 hp General Electric Dash 8-40CM locomotives was well-advanced at year end. All are scheduled for delivery in April and May, 1990.

The new locomotives will replace 29 Alco 3,000 hp locomotives being progressively retired from service. The acquisition is part of an ongoing major fleet modernization program which also includes re-engining twenty-seven 1,800 hp yard locomotives, built by Montreal Locomotive Works in the late 1950s and early '60s, with 16-cylinder

Newly constructed General Electric Dash 8-40CM locomotives in Erie, Pennsylvania.

Caterpillar diesel engines. The re-engining project is under way at the railway's Squamish repair and rebuild facility.

The new General Electric units have a larger cab, improved console lay-out and an advanced control system for improved reliability. They are also equipped with an advanced remote control radio system to provide more versatility for in-train positioning of the locomotives.

Throughout the year, work continued on upgrading the railway's nine-car fleet of Budd passenger cars, eight of which have now been completed. The refurbishment program, also carried out in Squamish, included interior decor, seating, galley and washroom improvements and a new exterior color scheme. Passenger ridership again increased in 1989, largely the result of growing support from North American and European tour wholesalers, and in mid-year an agreement was reached with a Japanese company to carry tour

The railway took over responsibility for steam train operations and maintenance in spring, 1989.

groups in 1990. Passenger train operations achieved 87.5 per cent on-time performance during 1989.

Following discussions with the provincial government, BC Rail assumed responsibility during the year for the operation and maintenance of the Royal Hudson steam train, which operates between North Vancouver and Squamish during the summer months.

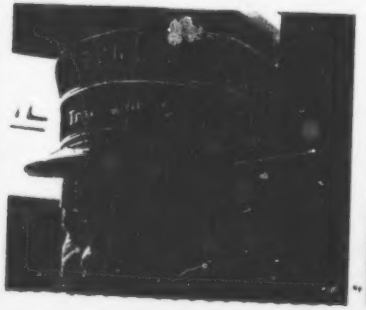
Rebuilding continues

Engineering activity during the year focused on the railway's Port subdivision and on trackage between Lillooet and Williams Lake, B.C., where substantial investments were made in roadbed improvements, installation of continuous welded rail and tie replacement. South of Lillooet, the new tunnel at Shalalth was officially opened, enabling the railway to bypass an area subject to rockfall and grade slippage.

In 1990, capital expenditure plans call for continuing roadbed improvements and at the beginning of the year, negotiations to rehabilitate and possibly re-open 197.5 miles of track between Fort St. James and Sloane, B.C. were in progress. If a satisfactory agreement is concluded, the line will serve a number of forest products companies who will become active in the Takla-Sustut forestry region.

In North Vancouver, more than $4 million is being invested in the modernization and expansion of the railway's southern terminus, where an industrial waste treatment plant and a monitoring and sampling station have been constructed on the sanitary sewer system. Other improvements include the installation of high-mast lighting; new intermodal handling equipment; access roads; parking lots and an automated fuelling system. Long-term plans include the addition of mobile yard repair units for freight cars, fencing and landscaping.

A positive labour-management relationship prevailed during 1989 and cooperation between the seven-member Council of Trade Unions



and the company continued as it has in recent years. The seven collective agreements expire on June 30, 1990 and at the end of 1989, preparations for contract negotiations were under way.

As a result of a substantial pension fund surplus, employees and the company enjoyed a contribution holiday during the year, which will continue through the current year.

Pension investment diversification is proceeding. A series of explanatory meetings for all contributing employees and retired pension fund members was held throughout the system during the year.

Demand for the company's telecommunications services remained high in 1989. The telecommunications business unit — which markets voice and data transmission capacity surplus to railway requirements — reported a 25 per cent increase in business volume. As well, a four-year microwave upgrade program between North Vancouver and Prince George is under way and the department is in the final stages of a project designed to improve trackside radio coverage of the train dispatch voice system. Voice radio communications between trackside locations and the train dispatch centre have been enhanced by the addition of 21 radio sites and the installation of a computer-assisted radio control system.

Activity overseas

The company's consulting unit, International Rail Consultants (IRC), was engaged during the year in a three-year locomotive rehabilitation program in Cameroon; a four-year training program for Bangladesh Railways and a three-year technical assistance program for the nine member countries of the Southern African Development Co-ordination Conference. IRC is a joint venture between the railway and Sandwell Inc.

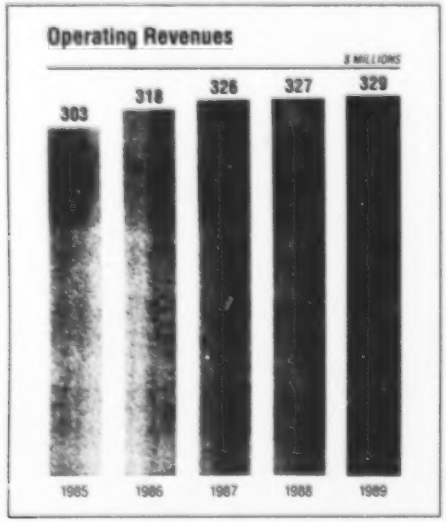
The Information Services department assisted the Marketing and Sales division with systems aimed at increasing new business opportunities through the provision of more timely and comprehensive information. The department also supported the Finance division in implementing a new accounts payable system and launched a corporate office automation planning project.

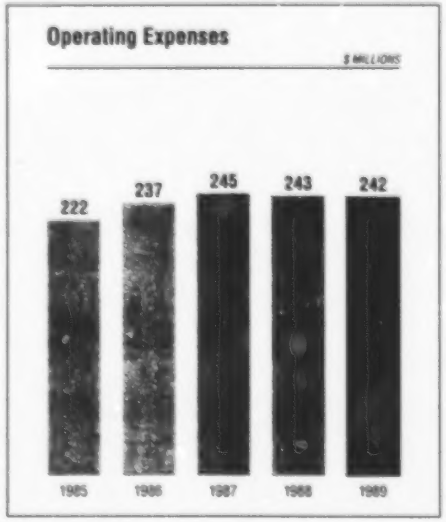
At year end, negotiations were under way with the company's financial advisers to secure offshore financing for the new locomotives being built in Erie, Pennsylvania by the General Electric Company.

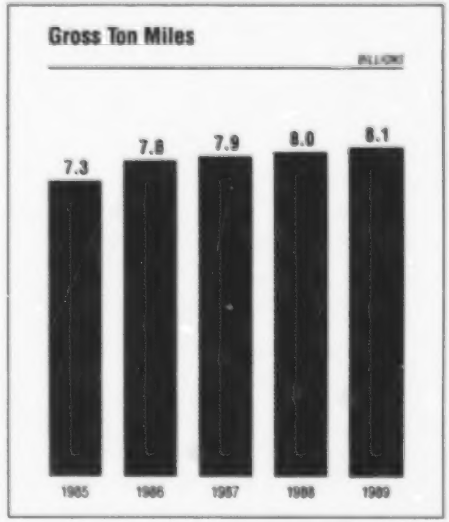
Electrically hauled coal trains switch to diesel power at Tacheeda Junction, where BC Rail's electrified subdivision joins the mainline.

In the human resources area, a comprehensive employee training program has been approved and is in the process of being implemented throughout the system. Work continues on the introduction of a revised salary administration program, which more closely links salary adjustments with employee performance.

The group's real estate subsidiary, BCR Properties Ltd., is negotiating to sell approximately 400 acres of its





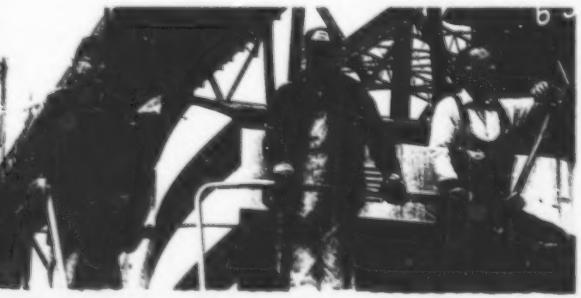


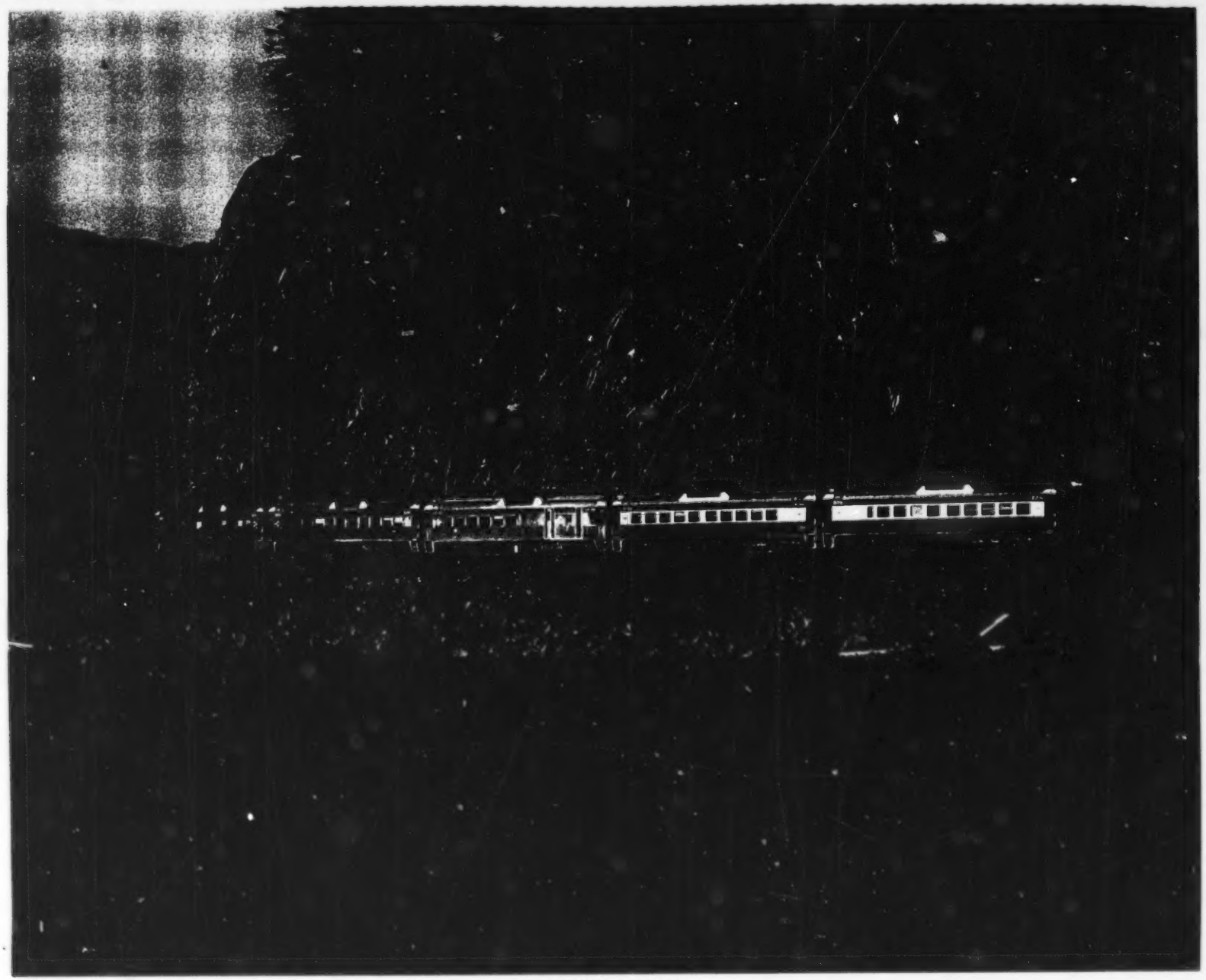
holdings in Williams Lake, B.C., for the construction of a fibreboard manufacturing facility and a co-generating electricity plant. Fibreboard production is expected to begin in 1992 and will make a significant contribution to BC Rail traffic originating in Williams Lake.

BCR Properties was also involved in the supply and construction of industrial trackage and components in Squamish, Prince George and Sundance, B.C., north of Chetwynd. Revenues from sales, leasing and other real estate activities are included in the consolidated financial statements.

The outlook for the years immediately ahead leaves no room for complacency. Competition will be even more demanding and it is evident that if the rail transportation industry is to prosper, rail transportation companies must take all possible steps to ensure that the conditions under which they operate are fair and equitable to all competing modes.

Freight transportation by rail is less damaging to the environment; it is the most fuel-efficient surface mode and it does not damage publicly funded highways and bridges. In BC Rail's view, a "level playing field" is necessary for fair competition between the various modes of transport so that market forces alone determine the allocation of freight. Competition should not be distorted by direct or indirect subsidies to any particular mode. In the meantime, BC Rail will be intensifying its effort to become more efficient in all aspects of its operations, in order to provide its customers with the best possible service at the best possible price.





Interior renovations and improvements to the Budd car passenger fleet continued through 1989.

British Columbia Railway Company
Consolidated Financial Statements

British Columbia Railway Company
Report of Management

The accompanying consolidated financial statements of British Columbia Railway Company and all other information contained in the Annual Report are the responsibility of management. The financial statements were prepared in conformity with generally accepted accounting principles appropriate in the circumstances in a manner consistent with the previous year and, accordingly, include some amounts based on management's best judgements and estimates. The financial information contained elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

Management is responsible for maintaining a system of internal accounting controls and procedures to provide reasonable assurance, at an appropriate cost/benefit relationship, that assets are safeguarded and that transactions are authorized, recorded and reported properly. The internal accounting control system is augmented by a program of internal audits and appropriate reviews by management, written policies and guidelines and a written Code of Business Conduct adopted by the Board of Directors, applicable to all employees of the company. Management believes that the company's internal accounting controls provide reasonable assurance that assets are safeguarded against material loss from unauthorized use or disposition and that the financial records are reliable for preparing financial statements and other data and maintaining accountability for assets.

The Audit and Finance Committee of the Board of Directors, composed solely of directors who are not officers of the company, meets with the independent auditors, management and internal auditors periodically to discuss internal accounting controls, auditing and financial reporting matters. The committee reviews with the independent auditors the scope and results of the audit effort. The committee also meets with the independent auditors without management present to ensure that the independent auditors have free access to the committee. The committee reviews the annual financial statements and recommends their approval by the Board of Directors.

The independent auditors, Coopers & Lybrand, are appointed by the Lieutenant Governor in Council to examine the financial statements of British Columbia Railway Company and conduct such tests and related procedures as they deem necessary in conformity with generally accepted auditing standards. The opinion of the independent auditors, based upon their examination of the financial statements, is contained in this Annual Report.

P. J. McElligott,
President and
Chief Executive Officer

J. R. Clarke,
Vice-President,
Finance and Information Services

Auditors' Report

To the Lieutenant Governor in Council
Province of British Columbia

We have examined the consolidated balance sheets of British Columbia Railway Company as at December 31, 1989 and 1988 and the statements of income and retained earnings and cash flow for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1989 and 1988 and the results of its operations and the changes in its cash position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Vancouver, Canada
February 5, 1990

British Columbia Railway Company
Consolidated Income and Retained Earnings
(Dollars in Thousands)

For the years ended December 31	1989	1988
Revenues		
Rail operations	$319,903	$ 319,710
Government assistance - Note 9	9,050	7,284
	328,953	326,994
Expenses		
Operations	67,974	70,674
Equipment	67,644	66,580
Road	45,570	45,516
Depreciation	36,985	35,853
General and administration	23,542	24,086
	241,715	242,709
Railway operating income	87,238	84,285
Non-operating income (expense)		
Interest - Note 10	(8,663)	(11,145)
Other income	4,838	3,676
Large Corporations tax	(931)	0
Income before minority interest and extraordinary item	82,482	76,816
Minority interest	17,893	18,500
Income before extraordinary item	64,589	58,316
Extraordinary item - Note 2	80,646	0
Net income (loss)	(16,057)	58,316
Retained earnings, beginning of year	176,014	128,006
	159,957	186,322
Dividends paid	10,308	10,308
Retained earnings, end of year	$149,649	$ 176,014

On behalf of the Board

Gerry Strongman, *Director*

Paul McElligott, *Director*

British Columbia Railway Company
Consolidated Balance Sheets
(Dollars in Thousands)

December 31	1989	1988
Assets		
Current assets		
Cash and short-term investments	$ 44,787	$ 22,693
Accounts receivable	40,003	38,441
Material and other items	38,553	33,747
	123,343	94,881
Property and equipment		
Road and buildings	1,247,501	1,182,069
Equipment	284,539	271,636
	1,532,040	1,453,705
Accumulated depreciation	339,037	308,535
	1,193,003	1,145,170
Dease Lake extension - Note 2	0	98,020
	$1,316,346	$ 1,338,071
Liabilities and Shareholder's Equity		
Current liabilities		
Accounts payable	$ 100,218	$ 80,427
Current obligations on long-term debt	26,954	1,766
	127,172	82,193
Long-term debt - Note 3	84,235	111,460
Minority interest - Note 4	186,886	200,000
Shareholder's equity		
Share capital - Note 5	257,688	257,688
Contributed surplus	510,716	510,716
Retained earnings	149,649	176,014
	918,053	944,418
Commitments - Note 6		
Contingent liabilities - Note 7		
	$1,316,346	$ 1,338,071

British Columbia Railway Company
Consolidated Cash Flow

(Dollars in Thousands)

For the years ended December 31	**1989**	1988
Operating activities		
Income before extraordinary item	**$ 64,589**	$ 58,316
Add (deduct)		
Item not affecting working capital		
Depreciation	**36,985**	35,853
Net changes in non-cash working capital		
Accounts receivable	**(1,562)**	(1,310)
Material and other items	**(4,806)**	1,857
Accounts payable	**20,043**	(18,526)
Interest	**8,663**	11,145
Minority interest in earnings	**17,893**	18,500
	141,805	105,835
Investing activities		
Additions to property and equipment	**(71,561)**	(69,851)
Change in payables for equipment purchases	**(252)**	(545)
Government assistance for capital items	**4,117**	5,496
	(67,696)	(64,900)
Financing activities		
Repayment of long-term debt	**(2,037)**	(1,736)
Interest	**(8,663)**	(11,145)
Minority interest in earnings	**(17,893)**	(18,500)
Reduction in minority interest	**(13,114)**	0
	(41,707)	(31,381)
Dividends paid	**(10,308)**	(10,308)
Increase (decrease) in cash	**22,094**	(754)
Cash and short-term investments, beginning of year	**22,693**	23,447
Cash and short-term investments, end of year	**$ 44,787**	$ 22,693

British Columbia Railway Company
Notes to Consolidated Financial Statements

1. SIGNIFICANT ACCOUNTING POLICIES

The accounting regulations prescribed by the National Transportation Agency of Canada have been adopted to the extent that this is possible without submitting specific accounting policies and depreciation rates to the Agency for approval.

Basis of consolidation

The consolidated financial statements include the accounts of British Columbia Railway Company and its subsidiaries, BC Rail Ltd. and BCR Properties Ltd. In these notes "company" refers to British Columbia Railway Company and its subsidiaries. All significant inter-company transactions are eliminated.

Class of business

The company provides a fully integrated rail freight service within British Columbia. Services other than hauling freight are not of sufficient size to warrant separate reporting.

Road property

New construction is recorded at cost net of Government grants. Abandoned or relocated sections are removed at average unit costs. Elements of track structure installed during planned programs are recorded at cost and the material replaced is removed at amounts which approximate average unit costs. Labour costs for programmed replacements are expensed as incurred.

Depreciation

Depreciation is provided for major categories of property and equipment on the straight-line basis at composite rates estimated to reduce the original cost to estimated salvage value over the average service lives of the classes. The group method is used for recording depreciation under which, on disposal, the original cost of assets retired less salvage value is charged against accumulated depreciation. No gain or loss on retirements, other than on accidental destruction of rolling stock and on disposal of land, is included in income. The original cost of assets less estimated salvage value is depreciated over the following number of years:

	Number of years
Grade and tunnels	100
Rail	35
Ties	15
Ballast	25
Bridges	30 - 80
Locomotives and power units	25
Freight cars	15 - 33

Repairs

Repairs and non-programmed replacements of track structure are charged against current operations. Betterments and major track relocations are capitalized.

Material and supplies

Inventories of material and supplies are valued at the lower of average cost and net realizable value.

Government assistance

Grants directly related to the construction or rehabilitation of road property have offset related road property capital expenditures. Operating assistance has been deducted from the related expense accounts or included in revenue.

Income taxes

Income tax expense is computed on the basis of accounting income recorded by BC Rail Ltd. The income of British Columbia Railway Company and BCR Properties Ltd. is exempt from income taxes.

Transactions in foreign currency

Transactions originating in foreign currency are translated at the approximate exchange rates prevailing at the dates of the transactions. Assets and liabilities denominated in foreign currency at the balance sheet date are translated to equivalent Canadian amounts at the current rate of exchange.

Leases

Certain long-term lease transactions relating to the financing of equipment are accounted for as purchases. The capital lease obligations reflect the present value of future minimum rental payments discounted at the interest rate implicit in the leases. The capitalized values of depreciable assets are generally depreciated over the related lease terms in equal annual amounts. Costs of all other leases are charged against operations as incurred.

2. EXTRAORDINARY ITEM

Construction on the incomplete Dease Lake extension was suspended in 1977 and there were no commitments to continue. Construction costs amounted to $98 million. During 1989, costs relating to the northernmost 340 kilometres of the incomplete extension in the amount of $80.6 million were determined to have no future economic benefit to the company and were written off. The construction costs of $17.4 million relating to the remaining 80 kilometres of the extension are included with the operating assets.

3. LONG-TERM DEBT

Long-term debt outstanding, less current maturities, consists of the following (in thousands):

	1989	1988
Sinking fund bonds and debentures payable to the Province of British Columbia (the Province)		
11.00% due June 1995	**$ 25,000**	$ 25,000
10.99% due August 2005	**24,490**	24,490
	49,490	49,490
Less sinking fund	**935**	654
	48,555	48,836
Bond payable to the Province		
10.75% due February 1990	**25,000**	25,000
Capital lease obligations - Notes 6 and 12	**37,634**	39,390
	111,189	113,226
Deduct current portion	**26,954**	1,766
	$ 84,235	$111,460

4. MINORITY INTEREST

The minority interest consists of 7,475,445 (1988 - 8,000,000) series 1-A first preferred shares with a par value of $25 each issued by BC Rail Ltd. These shares are designated as $2.3125 cumulative, redeemable and retractable.

BC Rail Ltd. must make all reasonable efforts in each quarter to purchase for cancellation in the open market three-quarters of 1% of the series 1-A preferred shares outstanding at the beginning of the quarter at a price not to exceed $25 per share and all transaction costs. If it is unable to fulfill its obligation in any calendar quarter the obligation will carry over only to the successive calendar quarters of the same calendar year and will thereafter be extinguished. On June 1, 1989, these shares were retractable at par at the option of the holder. Holders of 524,555 shares exercised this right of retraction and these shares were acquired for $13.1 million and subsequently cancelled.

5. SHARE CAPITAL

Authorized

10,000,000 shares with a par value of $100 each.

Issued and outstanding

2,576,885 shares held by the Province.

As all of the shares are held by the Province, earnings per share have not been provided.

6. COMMITMENTS

The company has significant lease commitments for rolling stock and additional minor lease commitments for equipment and real estate which expire at various dates prior to the year 2003. Certain of these leases transfer substantially all of the benefits and risks of ownership to the company and are accounted for as capital assets.

The following is a schedule of future minimum rental payments at December 31, 1989 required under non-cancellable leases that have remaining terms in excess of one year (in thousands):

	Capital leases	Operating leases
1990	$ 6,734	$13,301
1991	6,734	11,594
1992	6,734	10,269
1993	6,734	8,295
1994	6,734	4,338
Later years	37,348	12,703
Total minimum lease payments	71,018	$60,500
Less		
Executory costs	5,196	
Imputed interest	28,188	
Present value	$ 37,634	

Assets under capital leases recorded in the property and equipment accounts as at December 31, 1989 are as follows (in thousands):

Equipment	$ 46,283
Accumulated depreciation	17,502
	$ 28,781

As at December 31, 1989 the company had outstanding purchase commitments for the acquisition of material and equipment amounting to $62 million.

7. CONTINGENT LIABILITIES

The company is contingently liable with respect to pending litigation and claims arising in connection with construction and in the normal course of business. In the opinion of management any liability that may arise will be capitalized or would not have a material adverse effect on future income.

8. INCOME TAX

At December 31, 1989, BC Rail Ltd. had approximately $81 million excess income tax value over net book value of depreciable property and equipment which can be used to reduce future years' earnings for income tax purposes. The effect of such benefits, approximating $38 million, will be recognized in the accounts in the future as they are realized.

9. GOVERNMENT ASSISTANCE

Government assistance was as follows (in thousands):

	1989	1988
Unapplied, beginning of year	$ 0	$ 0
Contributions during the year		
From the Province		
Fort Nelson extension		
Operating	4,787	4,150
Rehabilitation	7,198	8,330
Passenger operation	2,868	2,500
Passenger car modernization	482	1,597
	15,335	16,577
From the Government of Canada		
Grain transportation	1,395	634
	16,730	17,211
Total available	16,730	17,211
Applied as follows		
Revenue		
Fort Nelson extension	4,787	4,150
Passenger operation	2,868	2,500
Grain transportation	1,395	634
	9,050	7,284
Operating expenses		
Fort Nelson extension	2,714	2,834
Passenger car modernization	331	1,597
	3,045	4,431
Property and equipment	4,117	5,496
Total applied	16,212	17,211
Unapplied, end of year	$ 518	$ 0

10. INTEREST EXPENSE

Interest expense was as follows (in thousands):

	1989	1988
Interest on long-term debt and notes to the Province	**$8,123**	$ 8,140
Less		
Sinking fund earnings	**89**	49
Interest earned on temporary investments	**4,002**	1,734
	4,091	1,783
	4,032	6,357
Interest on capital lease obligations	**4,631**	4,788
Net interest	**$8,663**	$11,145

11. PENSION PLAN AND POSTEMPLOYMENT BENEFITS

The company maintains a contributory defined benefit plan which covers substantially all of its employees. The plan provides pensions based on length of service and average earnings.

An actuarial valuation of the plan as at January 1, 1990 indicated that the accrued benefit obligations and the net assets available to provide for these obligations are as follows:

Accrued benefit obligations	$182 million
Pension fund assets	$214 million

To reduce the excess of pension fund assets over the accrued pension obligations, the joint Pension Committee instituted a contribution holiday effective March 1989.

The company also provides basic medical insurance coverage for all retired employees. The cost of the premiums is charged to income as they are paid.

12. RELATED PARTY TRANSACTIONS

Related party information not presented elsewhere in the notes to financial statements is presented below.

First preferred shares of BC Rail Ltd. and certain capital lease obligations are guaranteed by the Province. The Ministry of Finance and Corporate Relations of the Province acts as fiscal agent and the Superannuation Commission of the Province administers the company pension plan. Fees are charged for both of these services.

Except for income tax as described in Note 1, the company is subject to all taxes levied by the Province except most property taxes. All other transactions between the company and the Province are at terms no more or less favourable than those with unrelated parties.

British Columbia Railway Company
Five-Year Review
Consolidated Statement
(Dollars in Thousands)

	FISCAL YEAR				
	1989	1988	1987	1986	1985
Revenues					
Rail operations	**$ 319,903**	$ 319,710	$315,707	$308,659	$295,916
Government assistance	**9,050**	7,284	9,890	9,151	7,077
	328,953	326,994	325,597	317,810	302,993
Expenses					
Operations	**67,974**	70,674	71,216	67,928	67,424
Equipment	**67,644**	66,580	67,042	69,171	62,682
Road	**45,570**	45,516	48,117	43,274	38,468
Depreciation	**36,985**	35,853	34,870	32,359	30,425
Other	**23,542**	24,086	23,542	24,046	23,438
	241,715	242,709	244,787	236,778	222,437
Railway operating income	**87,238**	84,285	80,810	81,032	80,556
Non-operating income (expense)					
Interest	**(8,663)**	(11,145)	(11,839)	(13,687)	(18,442)
Other income	**4,838**	3,676	3,267	4,730	(351)
Large Corporations tax	**(931)**	—	—	—	—
	(4,756)	(7,469)	(8,572)	(8,957)	(18,793)
Income before deferred income taxes	**82,482**	76,816	72,238	72,075	61,763
Provision for (recovery of) deferred income taxes	**—**	—	(517)	2,138	333
Income before minority interest	**82,482**	76,816	72,755	69,937	61,430
Minority interest	**17,893**	18,500	18,500	18,500	18,500
Income before extraordinary item	**64,589**	58,316	54,255	51,437	42,930
Extraordinary item	**80,646**	—	—	—	—
Net income (loss)	**$ (16,057)**	$ 58,316	$ 54,255	$ 51,437	$ 42,930
CARLOADINGS					
Total revenue cars loaded on line	**215,651**	222,762	229,506	232,367	232,115
Received from connections	**2,991**	3,209	3,656	3,330	2,220
Total carloadings	**218,642**	225,971	233,162	235,697	234,335
MOTIVE POWER – Electric	**7**	7	7	7	7
– Diesel	**114**	116	117	109	110
ROLLING STOCK – Freight	**9,914**	9,908	10,107	10,146	9,960
– Passenger	**9**	9	9	9	9
– Boarding and work	**505**	469	449	455	452
TONS HAULED	**16,955,000**	17,340,000	17,670,000	17,854,000	17,832,000
EMPLOYEES AT YEAR END	**2,700**	2,700	2,760	2,660	2,620

British Columbia Railway Company
Financial Review

Financial Summary

The consolidated net loss for 1989 of $16.1 million was primarily the result of the write-off of $80.6 million relating to the northernmost portion of the Dease Lake extension, recorded as an extraordinary charge against income in the 1989 accounts.

Prior to the above-noted item, income for 1989 was $64.6 million, up 11% from the net income of $58.3 million for 1988. A small reduction in operating expenses was achieved despite wage increases and an increase of $1.1 million in depreciation resulting from capital additions.

Revenues

Reductions in carload lumber destined for eastern U.S. and Canadian markets and in coal from the northeast coal fields curtailed any increase in freight revenue in 1989. Commodities showing some increases over 1988 revenue levels included sulphur from the Peace River area, export pulp, and export woodchips. Rent from equipment declined to 11% (1988 - 12%) of total revenue, the result of reduced carloadings in commodities moving to North American markets.

Expenses

Consolidated operating expenses decreased $1.0 million to $241.7 million for 1989. Increases in materials costs, particularly fuel, were offset by some reductions in labour and other costs.

As a result of both increased price and usage, fuel costs climbed 11% over 1988 levels. Total number of trains run increased 5% over 1988 levels while total yard shifts stayed constant. The favourable price per litre of diesel fuel experienced in 1988 did not extend into 1989, reflecting increased world prices.

Labour costs for 1989 were favorably impacted by the pension contribution holiday in effect for the period from January 1989. This was implemented by the company as a means for reducing the excess of pension fund assets over the accrued pension obligations. At December 31, 1989 this excess amounted to $32 million on accrued benefit obligations of $182 million. The favourable impact of this in 1989 was reflected in both operating expenses and the capital projects worked on by company employees.

The completion of a contract for the construction of bulkhead flat cars in the Mechanical department's Squamish shops provided improved utilization of that facility. Further contracts of this nature will be pursued as they are an effective means of recovering some of the costs associated with maintaining the staff levels and overheads of a major shop.

Depreciation costs increased $1.1 million (3%) over 1988 levels, the result of the continued emphasis on upgrading the company's physical plant. This emphasis is also reflected in the expenses incurred in road maintenance. The labour costs for programmed replacement of rail, ties, and other track material are expensed as incurred. These labour costs amounted to over $12 million in 1989.

Operating Ratio

The company's operating ratio, the ratio of operating expenses including depreciation, to revenue, improved in 1989 to .73 (1988 - .74).

Non-Operating Items

Interest expense was further reduced in 1989 to $8.7 million, a $2.5 million (22%) reduction from 1988. Since 1985 when interest expense was $18.4 million, it has been reduced by $9.7 million.

The increase in other income on the consolidated income statement to $4.8 million reflects the increases in income from land sales by BCR Properties, the subsidiary that owns and manages the group's non-operating real estate assets.

The implementation July 1, 1989 of a Large Corporations tax by the federal government resulted in an additional $.9 million in costs for the company for the second half of 1989.

Minority Interest

The minority interest on the consolidated income statement reflects the payment of dividends by the operating subsidiary, BC Rail Ltd., to holders of its series 1-A preferred shares. A retraction of $13.1 million of these shares during 1989 resulted in a $.6 million reduction in the minority interest expense on the consolidated statements.

Extraordinary Item

The 1989 extraordinary charge of $80.6 million is the write-off of the net construction costs for 340 kilometres of railway grade, the northernmost portion of the Dease Lake extension, as described more fully in Note 2 of the Notes to Consolidated Financial Statements.

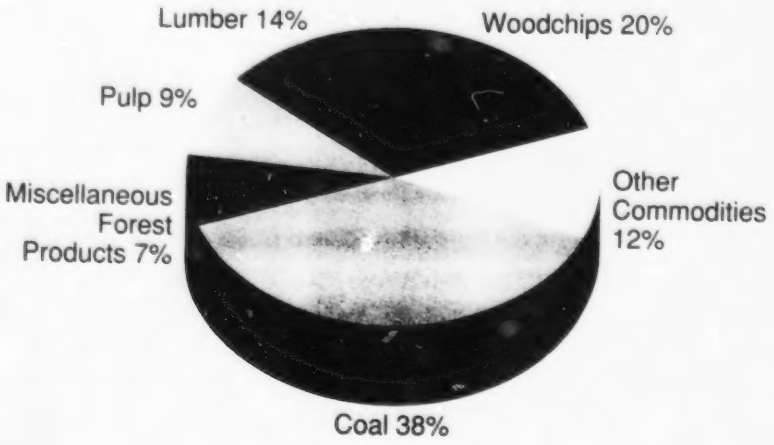
Dividends Paid

In 1989 British Columbia Railway Company paid its shareholder, the Province of British Columbia, a dividend of $10.3 million on its common shares. This is the fourth successive year that a dividend of this amount has been paid.

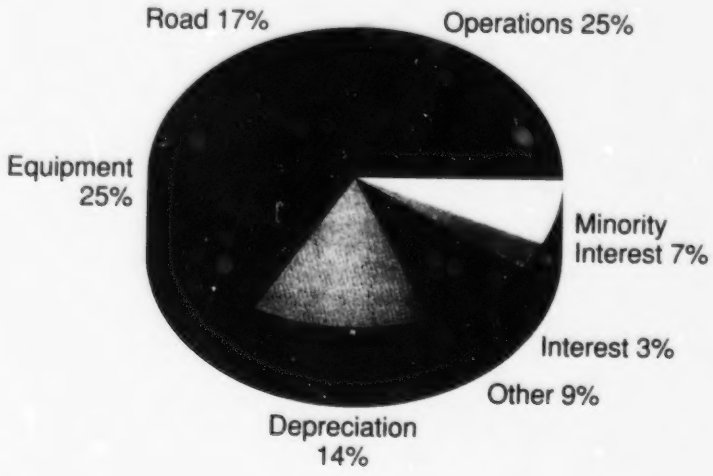
Additional Comments

Substantially all of the group's operations are conducted by BC Rail Ltd., for which additional discussion and analysis is provided.

Revenue Tons by Commodity



Consolidated Expenses



Helper locomotives awaiting freight at D'Arcy, B.C.

BC Rail Ltd.
Financial Statements

BC Rail Ltd.
Report of Management

The accompanying financial statements of BC Rail Ltd. and all other information contained in the Annual Report are the responsibility of management. The financial statements were prepared in conformity with generally accepted accounting principles appropriate in the circumstances in a manner consistent with the previous year and, accordingly, include some amounts based on management's best judgements and estimates. The financial information contained elsewhere in this Annual Report is consistent with that in the financial statements.

Management is responsible for maintaining a system of internal accounting controls and procedures to provide reasonable assurance, at an appropriate cost/benefit relationship, that assets are safeguarded and that transactions are authorized, recorded and reported properly. The internal accounting control system is augmented by a program of internal audits and appropriate reviews by management, written policies and guidelines and a written Code of Business Conduct adopted by the Board of Directors, applicable to all employees of the company. Management believes that the company's internal accounting controls provide reasonable assurance that assets are safeguarded against material loss from unauthorized use or disposition and that the financial records are reliable for preparing financial statements and other data and maintaining accountability for assets.

The Audit and Finance Committee of the Board of Directors, composed solely of directors who are not officers of the company, meets with the independent auditors, management and internal auditors periodically to discuss internal accounting controls, auditing and financial reporting matters. The committee reviews with the independent auditors the scope and results of the audit effort. The committee also meets with the independent auditors without management present to ensure that the independent auditors have free access to the committee. The committee reviews the annual financial statements and recommends their approval by the Board of Directors.

The independent auditors, Coopers & Lybrand, are appointed by the shareholders to examine the financial statements of BC Rail Ltd. and conduct such tests and related procedures as they deem necessary in conformity with generally accepted auditing standards. The opinion of the independent auditors, based upon their examination of the financial statements, is contained in this Annual Report.

P. J. McElligott,
President and
Chief Executive Officer

J. R. Clarke,
Vice-President,
Finance and Information Services

Auditors' Report

To the Shareholders

We have examined the balance sheets of BC Rail Ltd. as at December 31, 1989 and 1988 and the statements of loss and deficit, contributed surplus and cash flow for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1989 and 1988 and the results of its operations and the changes in its cash position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Vancouver, Canada
February 5, 1990

BC Rail Ltd.
Loss and Deficit
(Dollars in Thousands)

For the years ended December 31	1989	1988
Revenues		
Rail operations	$ 319,903	$ 319,710
Government assistance - Note 8	9,050	7,284
	328,953	326,994
Expenses		
Operations	67,974	70,674
Equipment	67,644	66,580
Road	45,570	45,516
Depreciation	36,985	35,853
General and administration	23,542	24,086
	241,715	242,709
Railway operating income	87,238	84,285
Non-operating income (expense)		
Interest - Note 9	(85,316)	(89,889)
Other income	1,898	1,720
Large Corporations tax	(931)	0
Income (loss) before extraordinary item	2,889	(3,884)
Extraordinary item - Note 2	80,646	0
Net loss	77,757	3,884
Deficit, beginning of year	4,949	1,065
Deficit, end of year	$ 82,706	$ 4,949

On behalf of the Board

Gerry Strongman, *Director*

Paul McElligott, *Director*

BC Rail Ltd.
Balance Sheets
(Dollars in Thousands)

December 31	1989	1988
Assets		
Current assets		
Cash and short-term investments	$ 44,787	$ 22,693
Accounts receivable	40,003	38,441
Material and other items	38,530	33,723
	123,320	94,857
Property and equipment		
Road and buildings	1,242,270	1,177,200
Equipment	284,539	271,636
	1,526,809	1,448,836
Accumulated depreciation	339,037	308,535
	1,187,772	1,140,301
Dease Lake extension - Note 2	0	98,020
	$ 1,311,092	$ 1,333,178
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable	$ 97,997	$ 78,199
Current obligations on long-term debt	67,007	1,574
Due to related companies	87,286	56,895
	252,290	136,668
Long-term debt - Note 3	610,170	738,114
Shareholders' equity		
Share capital - Note 4	399,576	411,690
Contributed surplus	131,762	51,655
Deficit	(82,706)	(4,949)
	448,632	458,396
Commitments - Note 5		
Contingent liabilities - Note 6		
	$ 1,311,092	$ 1,333,178

BC Rail Ltd.
Contributed Surplus
(Dollars in Thousands)

December 31	1989	1988
Balance, beginning of year	**$ 51,655**	$72,155
Contributed on issue of shares - Note 4	**100,000**	0
	151,655	72,155
Dividends paid		
Preferred shares	**17,893**	18,500
Common shares	**2,000**	2,000
	19,893	20,500
Balance, end of year	**$ 131,762**	$51,655

BC Rail Ltd.
Cash Flow
(Dollars in Thousands)

For the years ended December 31	1989	1988
Operating activities		
Income (loss) before extraordinary item	**$ 2,889**	$ (3,884)
Add (deduct)		
Item not affecting working capital		
Depreciation	**36,985**	35,853
Net changes in non-cash working capital		
Accounts receivable	**(2,493)**	(1,310)
Material and other items	**(4,807)**	1,857
Accounts payable	**20,981**	(18,535)
Related company accounts	**30,391**	100,920
Interest	**85,316**	89,889
	169,262	204,790
Investing activities		
Additions to property and equipment	**(71,199)**	(69,904)
Change in payables for equipment purchases	**(252)**	(545)
Government assistance for capital items	**4,117**	5,496
	(67,334)	(64,953)
Financing activities		
Issue of long-term debt	**40,245**	0
Repayment of long-term debt	**(102,756)**	(30,202)
Interest	**(85,316)**	(89,889)
Issue of preferred shares	**101,000**	0
Redemption of preferred shares	**(13,114)**	0
	(59,941)	(120,091)
Dividends paid	**(19,893)**	(20,500)
Increase (decrease) in cash	**22,094**	(754)
Cash and short-term investments, beginning of year	**22,693**	23,447
Cash and short-term investments, end of year	**$ 44,787**	$ 22,693

BC Rail Ltd.
Notes to Financial Statements

1. SIGNIFICANT ACCOUNTING POLICIES

The accounting regulations prescribed by the National Transportation Agency of Canada have been adopted to the extent that this is possible without submitting specific accounting policies and depreciation rates to the Agency for approval.

Class of business

The company provides a fully integrated rail freight service within British Columbia. Services other than hauling freight are not of sufficient size to warrant separate reporting.

Road property

New construction is recorded at cost net of Government grants. Abandoned or relocated sections are removed at average unit costs. Elements of track structure installed during planned programs are recorded at cost and the material replaced is removed at amounts which approximate average unit costs. Labour costs for programmed replacements are expensed as incurred.

Depreciation

Depreciation is provided for major categories of property and equipment on the straight-line basis at composite rates estimated to reduce the original cost to estimated salvage value over the average service lives of the classes. The group method is used for recording depreciation under which, on disposal, the original cost of assets retired less salvage value is charged against accumulated depreciation. No gain or loss on retirements, other than on accidental destruction of rolling stock and on disposal of land, is included in income. The original cost of assets less estimated salvage value is depreciated over the following number of years:

	Number of years
Grade and tunnels	100
Rail	35
Ties	15
Ballast	25
Bridges	30 - 80
Locomotives and power units	25
Freight cars	15 - 33

Repairs

Repairs and non-programmed replacements of track structure are charged against current operations. Betterments and major track relocations are capitalized.

Material and supplies

Inventories of material and supplies are valued at the lower of average cost and net realizable value.

Government assistance

Grants directly related to the construction or rehabilitation of road property have offset related road property capital expenditures. Operating assistance has been deducted from the related expense accounts or included in revenue.

Income taxes

Income tax expense is computed on the basis of accounting income recorded by the company.

Transactions in foreign currency

Transactions originating in foreign currency are translated at the approximate exchange rates prevailing at the dates of the transactions. Assets and liabilities denominated in foreign currency at the balance sheet date are translated to equivalent Canadian amounts at the current rate of exchange.

Leases

Certain long-term lease transactions relating to the financing of equipment are accounted for as purchases. The capital lease obligations reflect the present value of future minimum rental payments discounted at the interest rate implicit in the leases. The capitalized values of depreciable assets are generally depreciated over the related lease terms in equal annual amounts. Costs of all other leases are charged against operations as incurred.

2. EXTRAORDINARY ITEM

Construction on the incomplete Dease Lake extension was suspended in 1977 and there were no commitments to continue. Construction costs amounted to $98 million. During 1989, costs relating to the northernmost 340 kilometres of the incomplete extension in the amount of $80.6 million were determined to have no future economic benefit to the company and were written off. The construction costs of $17.4 million relating to the remaining 80 kilometres of the extension are included with the operating assets.

3. LONG-TERM DEBT

Long-term debt outstanding, less current maturities, consists of the following (in thousands):

	1989	1988
Capital lease obligations—		
Notes 5 and 11	**$ 37,634**	$ 39,390
Deduct current portion	**1,762**	1,574
	35,872	37,816
Notes payable to British Columbia Railway Company		
10.75%, due February 1990	**25,000**	25,000
0.00%, due June 1990	**40,245**	0
9.70%, due June 1991	**62,210**	62,210
9.96%, due June 1992	**68,245**	68,245
10.40%, due June 1995	**41,343**	56,350
12.75%, due July 1995	**0**	85,993
	237,043	297,798
Deduct current portion	**65,245**	0
	171,798	297,798
Notes payable to BCR Properties Ltd.		
14% due June 1999	**402,500**	402,500
	$ 610,170	$ 738,114

4. SHARE CAPITAL

Authorized

5,000,000 common shares with a par value of $100 each.

20,000,000 first preferred shares with a par value of $25 each of which 8,000,000 are designated as $2.3125 cumulative redeemable retractable first preferred shares, series 1-A.

20,000,000 second preferred shares with a par value of $100 each. They are non-cumulative, redeemable and retractable. 3,000,000 have been designated as series 2-A and 10,000 have been designated as series 2-B. The series 2-B have a dividend rate of 8%.

Issued and outstanding ($ in thousands):

Shares	1989	1988
500,012 common	**$ 50,001**	$ 50,001
7,475,445 series 1-A preferred (1988 - 8,000,000)	**186,886**	200,000
1,616,892 series 2-A preferred	**161,689**	161,689
10,000 series 2-B preferred (1988 - nil)	**1,000**	0
	$ 399,576	$ 411,690

During the year, 10,000 series 2-B preferred shares were issued for a total consideration of $101 million of which $100 million has been credited to contributed surplus.

As all of the common shares are held by British Columbia Railway Company and its wholly owned subsidiary, earnings per share have not been provided.

The company must make all reasonable efforts in each quarter to purchase for cancellation in the open market three-quarters of 1% of the series 1-A preferred shares outstanding at the beginning of the quarter at a price not to exceed $25 per share and all transaction costs. If it is unable to fulfill its obligation in any calendar quarter, the obligation will carry over only to the successive calendar quarters of the same calendar year and will thereafter be extinguished. On June 1, 1989, these shares were retractable at par at the option of the holder. Holders of 524,555 shares exercised this right of retraction and these shares were acquired for $13.1 million and subsequently cancelled.

5. COMMITMENTS

The company has significant lease commitments for rolling stock and additional minor lease commitments for equipment and real estate which expire at various dates prior to the year 2003. Certain of these leases transfer substantially all of the benefits and risks of ownership to the company and are accounted for as capital assets.

The following is a schedule of future minimum rental payments at December 31, 1989 required under non-cancellable leases that have remaining terms in excess of one year (in thousands):

	Capital leases	Operating leases
1990	$ 6,734	$13,301
1991	6,734	11,594
1992	6,734	10,269
1993	6,734	8,295
1994	6,734	4,338
Later years	37,348	12,703
Total minimum lease payments	71,018	$ 60,500
Less		
Executory costs	5,196	
Imputed interest	28,188	
Present value	$ 37,634	

Assets under capital leases recorded in the property and equipment accounts as at December 31, 1989 are as follows (in thousands):

Equipment	$ 46,283
Accumulated depreciation	17,502
	$ 28,781

As at December 31, 1989 the company had outstanding purchase commitments for the acquisition of material and equipment amounting to $62 million.

6. CONTINGENT LIABILITIES

The company is contingently liable with respect to pending litigation and claims arising in connection with construction and in the normal course of business. In the opinion of management, any liability that may arise will be capitalized or would not have a material adverse effect on future income.

7. INCOME TAX

At December 31, 1989, the company had approximately $81 million excess income tax value over net book value of depreciable property and equipment which can be used to reduce future years' earnings for income tax purposes. The effect of such benefits, approximating $38 million, will be recognized in the accounts in the future as they are realized.

8. GOVERNMENT ASSISTANCE

Government assistance was as follows (in thousands):

	1989	1988
Unapplied, beginning of year	$ 0	$ 0
Contributions during the year		
From the Province		
Fort Nelson extension		
Operating	4,787	4,150
Rehabilitation	7,198	8,330
Passenger operation	2,868	2,500
Passenger car modernization	482	1,597
	15,335	16,577
From the Government of Canada		
Grain transportation	1,395	634
	16,730	17,211
Total available	16,730	17,211
Applied as follows		
Revenue		
Fort Nelson extension	4,787	4,150
Passenger operation	2,868	2,500
Grain transportation	1,395	634
	9,050	7,284
Operating expenses		
Fort Nelson extension	2,714	2,834
Passenger car modernization	331	1,597
	3,045	4,431
Property and equipment	4,117	5,496
Total applied	16,212	17,211
Unapplied, end of year	$ 518	$ 0

9. INTEREST EXPENSE

Interest expense was as follows (in thousands):

	1989	1988
Interest on notes payable		
BCR Properties Ltd.	**$ 56,350**	$ 56,350
British Columbia Railway Company	**26,716**	34,048
	83,066	90,398
Interest on capital lease obligations	**4,631**	4,788
	87,697	95,186
Less interest income		
Related companies	**(1,621)**	3,563
Other	**4,002**	1,734
	2,381	5,297
	$ 85,316	$ 89,889

10. PENSION PLAN AND POSTEMPLOYMENT BENEFITS

The company maintains a contributory defined benefit plan which covers substantially all of its employees. The plan provides pensions based on length of service and average earnings.

An actuarial valuation of the plan as at January 1, 1990 indicates that the accrued benefit obligations and the net assets available to provide for these obligations are as follows:

Accrued benefit obligations	$182 million
Pension fund assets	$214 million

To reduce the excess of pension fund assets over the accrued pension obligations, the joint Pension Committee instituted a contribution holiday effective March 1989.

The company also provides basic medical insurance coverage for all retired employees. The cost of the premiums is charged to income as they are paid.

11. RELATED PARTY TRANSACTIONS

Related party information not presented elsewhere in the notes to financial statements is presented below.

All of the outstanding common and second preferred shares of the company are owned as follows:

BCR Properties Ltd. (a wholly-owned subsidiary of British Columbia Railway Company)	75%
British Columbia Railway Company	25%

First preferred shares and certain capital lease obligations are guaranteed by the Province. The Ministry of Finance and Corporate Relations of the Province acts as fiscal agent and the Superannuation Commission of the Province administers the company pension plan. Fees are charged for both of these services.

The company is subject to all taxes levied by the Province except most property taxes. All other transactions between the company and the Province are at terms no more or less favourable than those with unrelated parties.

BC Rail Ltd.
Management Discussion & Analysis

BC Rail Ltd. is the railway operating subsidiary of the British Columbia Railway group. The following information is provided to investors in BC Rail Ltd. to assist in their understanding of the company's financial results and prospects, in accordance with the guidelines established by the Ontario Securities Commission and the Commission des Valeurs Mobilières du Québec.

General

Railway operating income increased 4% from 1988 to 1989. BC Rail Ltd.'s operating ratio, the ratio of operating expenses including depreciation to revenue, improved in 1989 to .73 (1988 - .74), the result of a small increase in revenues and a reduction in operating expenses.

The company's improved cash position during the year and a restructuring of intercompany debt resulted in a 5% reduction in interest expense. Interest on notes payable to related companies decreased by $7.3 million to $83.1 million in 1989 while interest income dropped to $2.4 million (1988 - $5.3 million).

The write-off of the northernmost portion of the Dease Lake extension during 1989 resulted in an extraordinary charge of $80.6 million on the 1989 statement of loss and deficit. The balance of construction costs for this extension, $17.4 million, has been classified under property and equipment on the 1989 balance sheet. It is anticipated that revenue will be earned from this remaining trackage commencing in 1991.

Arbitration is currently underway between the northeast coal shippers and the consortium of Japanese buyers in respect of the export price of coal under their contract. The results of the arbitration, expected in 1990, may retroactively impact the coal freight rates for the period subsequent to April 1, 1989. In 1989 coal revenue provided 21% of total freight revenues; therefore an adjustment in rates could have a significant impact on the income of BC Rail.

The annual impact of the federal government's Large Corporations tax is estimated at $2 million. This tax was implemented July 1, 1989.

Liquidity

Working capital was reduced by $87.2 million from 1988 to 1989. Current obligations on long-term debt will be funded from cash and short-term investments together with funds from operations.

Discussions are currently underway respecting the financing of 22 new 4,000 horsepower locomotives and their subsequent lease by the company.

Capital Resources

The 1990 capital expenditures are estimated to be $100 million. At December 31, BC Rail had commitments in place in respect to the acquisition of twenty-two 4,000 horsepower locomotives at an estimated total cost of $46 million. Other commitments at year end included the purchase of rail for the 1990 continuous welded rail relay program.

Funds generated from 1990 operations are anticipated to be sufficient to cover the capital, operating, and financing costs of the company; however short-term borrowings may be required. Sufficient lines of credit are maintained.

In the event that revenues are less than projected the company will resize the planned capital expenditures and discretionary maintenance programs such that additional financing is minimized.

Results of Operations

The flat revenue growth experienced from 1985 through 1989 reflects the competitive environment in which BC Rail operates. Revenue growth has averaged 2% per year during this period.

Increasing competition is exerting strong downward pressure on freight rates. The shift in woodchip traffic from export to local markets supplying B.C. pulp mills will reduce total freight revenues due to the shorter haul of these chips. These revenue reductions are anticipated to be offset by traffic from additional customer sites in 1990 as well as fewer disruptions in coal carloadings than in 1989.

Operating expense increases during 1985 through 1989 have been limited to less than 2% per year on average, despite wage increases and increased depreciation charges. This has been a result of a number of management initiatives to contain costs and maximize operational efficiency. The extensive capital programs, particularly the track upgrading to continuous welded rail, have assisted in establishing a cost effective operation. The BC Rail Ltd. three-year collective agreements with its union employees expire June 30, 1990.